STATE OF MICHIGAN

COURT OF APPEALS

DAVID C. LADD,

Plaintiff/Garnishor-Appellant/Cross-Appellee,

v

MOTOR CITY PLASTICS COMPANY,

Defendant,

and

UNITED BANK & TRUST,

Garnishee-Appellee/Cross-Appellant.

FOR PUBLICATION
October 31, 2013

No. 303018
Monroe Circuit Court
LC No. 08-025247-CK

Advance Sheets Version

Before: MURPHY, C.J., and JANSEN and MURRAY, JJ.

JANSEN, J. (*concurring in part and dissenting in part*).

I fully concur with parts I, II, III(A), III(B), and III(E) of the majority opinion. I must respectfully dissent, however, with respect to parts III(C) and III(D) of the majority opinion.

MCR 3.101(H) governs the matter of garnishee disclosures. The majority correctly points out that, among other things, MCR 3.101(H)(1)(a) requires a garnishee to "claim[] any setoff that the garnishee *would* have against the defendant . . . ." (Emphasis added). Given the language of this court rule, the majority concludes that *making a claim* of setoff is not the same as *exercising a right* of setoff. The majority goes on to conclude that, for purposes of MCR 3.101(H), a garnishee must only *claim* its right of setoff and need not ever actually *exercise* the right. I cannot agree.

In my opinion, the language of MCR 3.101(H)(1)(a), standing alone, is insufficient to answer the question presented in this case. As an initial matter, I believe that the majority's interpretation of MCR 3.101(H)(1)(a), permitting a garnishee to merely claim a right of setoff without ever exercising it, facilitates collusion between the garnishee and judgment debtor to defeat the garnishor's claim. Indeed, I believe this is exactly what happened in the present case. Plaintiff, as a judgment creditor, already had a valid, fully adjudicated claim against Motor City. Motor City had been in default on its loan obligations for six months at the time UBT's

garnishee disclosure was submitted on January 29, 2010. Yet UBT continued to allow Motor City to use its deposit accounts and withdraw funds therefrom, and, in fact, shortly thereafter discounted Motor City's notes and sold them, totally defeating the rights of the garnishor. UBT's actions in this regard were certainly inconsistent with any purported intent to set off. *Mich Carpenters' Council Pension Fund v Smith & Andrews Construction Co*, 681 F Supp 1252, 1255 (ED Mich, 1988).

Instead, I conclude that a garnishee must seasonably exercise its right of setoff in order to claim the setoff under MCR 3.101(H)(1)(a). The general rule is that "[w]here a garnishee claims a debt due from the debtor as a set-off, the garnishee *must in fact apply* such debt on the amount due from him or her to the debtor." 38 CJS, Garnishment, § 272, p 542 (emphasis added). Similarly, § 4-303(1) of the Uniform Commercial Code (UCC) suggests that a bank's right of setoff against a customer's deposit accounts is not effective until it is "exercised." See *Baker v Nat'l City Bank of Cleveland*, 511 F2d 1016, 1018 (CA 6, 1975); see also Official Comment 5 to UCC § 4-303(1) (stating that "[i]n the case of setoff the effective time is when the setoff is actually made"). The Michigan Legislature has adopted § 4-303(1) of the UCC, MCL 440.4303(1), evidencing a legislative intent that bank setoffs be "exercised" before becoming effective.

Perhaps more importantly, other courts have held that no setoff can be claimed until the bank performs some overt act accomplishing the setoff and makes a record verifying that the setoff has in fact been exercised. *Mich Carpenters' Council*, 681 F Supp at 1255; see also *Walters v Bank of America Nat'l Trust & Sav Ass'n*, 9 Cal 2d 46, 55-58; 69 P2d 839 (1937). "[T]he act must be unequivocal, objectively ascertainable and final . . . ." *Normand Josef Enterprises, Inc v Connecticut Nat'l Bank*, 230 Conn 486, 506; 646 A2d 1289 (1994). The law requires something more than a mere declaration of intent to exercise the setoff. See *Baker*, 511 F2d at 1018; see also *In re Archer*, 34 BR 28, 30 (Bkrtcy ND Tex, 1983).

It is undisputed that UBT never exercised the setoff against Motor City's deposit accounts. UBT did not withhold or remove money from the deposit accounts and certainly did not apply any of the deposited funds toward Motor City's loan debt. Nor did it, for obvious reasons, make any record verifying that it had made a setoff. At most, UBT declared its intent to possibly exercise a setoff at some future time. This was not sufficient. See *Baker*, 511 F2d at 1018. Mere declarations by a bank, accompanied by no affirmative acts or steps to record the transaction, are insufficient to support the bank's claimed right of setoff. *Id*. at 1019.

In order to properly invoke its claimed right of setoff against Motor City's deposit accounts, UBT was required to actually exercise the setoff and apply the deposited funds toward Motor City's outstanding loan debt. I conclude that, because UBT never exercised its claimed right of setoff against the funds in Motor City's deposit accounts, it was not entitled to claim the right on its garnishee disclosure or rely on the right to deny the release of Motor City's deposited funds to plaintiff under the writ of garnishment. See *Mich Carpenters' Council*, 681 F Supp at 1255.

I further conclude that, even if UBT had exercised its right of setoff, its subsequent actions unquestionably constituted a waiver of that right. "[A] garnishee's treatment of a debtor's assets which is inconsistent with the claimed setoff is a waiver of that right in the face of

the garnish[o]r's claim." *Id*. Even after submitting its garnishee disclosure, UBT continued to allow Motor City to use its deposit accounts and withdraw funds therefrom. In my opinion, this conduct amounted to a knowing waiver of any setoff right that UBT may have possessed.

It also strikes me that UBT waived its perfected security interest in Motor City's deposit accounts.[1] "A security interest . . . continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof *unless the secured party authorized the disposition free of the security interest* . . . ." MCL 440.9315(1)(a) (emphasis added). Under this section, which is derived from the former UCC § 9-306(2), a secured party that authorizes the disposition or dissipation of collateral waives its security interest in that specific collateral. See *Lifewise Master Funding v Telebank*, 374 F3d 917, 923-924 (CA 10, 2004); see also *Producers Cotton Oil Co v Amstar Corp*, 197 Cal App 3d 638, 647; 242 Cal Rptr 914 (1988); *Colorado State Bank of Walsh v Hoffner*, 701 P2d 151, 153 (Colo App, 1985). In my opinion, UBT waived its perfected security interest by authorizing Motor City to continue withdrawing funds from its deposit accounts after it had defaulted. See MCL 440.9315(1)(a); see also *In re Mycro-Tek, Inc*, 191 BR 188, 194-195 (Bkrtcy D Kan, 1996).

In sum, I do not believe that MCR 3.101(H)(1)(a) permits a garnishee to merely claim a right of setoff without actually exercising the right in a seasonable manner. On the contrary, I conclude that in order to claim a right of setoff on its garnishee disclosure under MCR 3.101(H)(1)(a), UBT was required to actually exercise the setoff and apply the funds in Motor City's deposit accounts toward the outstanding loan debt. See *Mich Carpenters' Council*, 681 F Supp at 1255. In my opinion, UBT is liable to plaintiff in the amount of Motor City's funds on deposit with the bank at the time the writ of garnishment was served on January 23, 2010, not to exceed the amount of the underlying judgment plus statutory interest. See MCR 3.101(O)(1). I would reverse the circuit court's ruling on this issue and remand for entry of judgment in favor of plaintiff accordingly.

/s/ Kathleen Jansen

[1] The loan documents executed by Motor City gave UBT a security interest in all of Motor City's deposit accounts at the bank. Under Michigan law, a security interest in a deposit account is perfected when the secured party is in control of the account. MCL 440.9314(1) and (2); *United States v One Silicon Valley Bank Account*, 549 F Supp 2d 940, 959 (WD Mich, 2008). A secured party has control of a deposit account if "[t]he secured party is the bank with which the deposit account is maintained." MCL 440.9104(1)(a).